GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING

Fiscal Note 2011 Biennium

Bill #	HB0206	**Title:**	Exempt military salaries from state income tax
Primary Sponsor:	Klock, Harry	**Status:**	As Introduced-Revised

- ☐ Significant Local Gov Impact
- ☐ Needs to be included in HB 2
- ☑ Technical Concerns
- ☐ Included in the Executive Budget
- ☐ Significant Long-Term Impacts
- ☐ Dedicated Revenue Form Attached

FISCAL SUMMARY

	FY 2010 Difference	FY 2011 Difference	FY 2012 Difference	FY 2013 Difference
Expenditures:				
General Fund	$0	$0	$0	$0
Revenue:				
General Fund	($2,133,000)	($1,533,000)	($1,533,000)	($1,533,000)
Net Impact-General Fund Balance	($2,133,000)	($1,533,000)	($1,533,000)	($1,533,000)

Description of fiscal impact: This bill would expand the income tax exemption for military salaries to include the National Guard and Reserves. This would reduce general fund revenue by about $1.5 million per year.

FISCAL ANALYSIS

Assumptions:

1. Under current law, military salaries received by members of the regular armed forces and by members of the National Guard and reserves who are on active duty are not subject to state income tax. This bill would extend that exemption to all military salaries of members of the National Guard and reserves, beginning with tax year 2009. (See Technical Note.) It would not exempt the civilian portion of salaries made by members of the National Guard and reserves.
2. Total salaries paid to the Montana National Guard and Reserves that would be exempted by this bill were $30.5 million in 2008 (Department of Military Affairs). Because deployments are expected to offset annual pay raises, total salaries in future years are assumed to be the same.
3. Most members of the Guard and Reserves have other jobs, and would continue to be subject to income tax on their non-military income. The reduction in tax liability for an affected taxpayer is found by multiplying the change in taxable income by the marginal tax rate. Some taxpayers affected by this bill would be moved to a lower tax bracket because of the reduction in their taxable income. For those

taxpayers, the reduction in tax liability would be the reduction in taxable income multiplied by a weighted average of their current marginal tax rate and their marginal tax rate with this bill in effect.

4. For 2007, the average marginal tax rate was 5.525%. To take into account taxpayers being moved to lower tax brackets, the weighted average marginal rate for taxpayers affected by this bill is assumed to be 0.5% lower, or 5.025%. The average marginal rate is assumed to be the same in future years.
5. This bill would reduce tax liability by $1.533 million (5.025% × $30.5 million) per year. Each fiscal year, income tax revenue will be reduced through lower withholding during the fiscal year and larger refunds or smaller payments with returns from the previous tax year. In each fiscal year, beginning with FY 2010, revenue will be reduced by the annual reduction in tax liability.
6. This bill would be effective on passage and approval and would apply retroactively to all of tax year 2009. Guard and Reserve members would have had taxes withheld from their salaries under current law during the first half of tax year 2009, which is in FY 2009. Thus, there would be no revenue reduction in FY 2009.
7. The revenue reduction associated with lower tax liability in FY 2009 will occur in FY 2010. Taxes withheld from Guard and Reserve salaries during the first half of tax year 2009 would be refunded when Guard and Reserve members file their 2009 tax returns in FY 2010. Withholding from guard and reserve salaries is approximately $1.2 million per year (Department of Military Affairs). Revenue in FY 2010 would be reduced by $2.133 million ($1.533 million in lower payments in FY 2010 + $0.6 million refunds from FY 2009).
8. Changes to tax forms required by this bill will be made as part of the annual update process with no additional costs to the Department of Revenue.

	FY 2010 Difference	**FY 2011 Difference**	**FY 2012 Difference**	**FY 2013 Difference**
Fiscal Impact:				
Revenues:				
General Fund (01)	($2,133,000)	($1,533,000)	($1,533,000)	($1,533,000)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	($2,133,000)	($1,533,000)	($1,533,000)	($1,533,000)

Technical Notes:

1. This bill may raise issues of federal pre-emption of state taxing authority. The section of federal law, 4USC111, that allows states to impose income tax on federal salaries, allows states to do so only “if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.” This bill may discriminate against federal employees whose salaries are paid from one source by exempting salaries paid from another source.

Sponsor’s Initials	*Date*	*Budget Director’s Initials*	*Date*